"The tone has been very positive, but we are not out of the woods"

Affirm's chief capital officer, **Brooke Major-Reid**, in an interview with *GlobalCapital* ahead of ABS East 2023

GlobalCapital spoke to Brooke Major-Reid, chief capital officer at San Francisco-based buy now pay later lender and ABS issuer Affirm, about the state of the ABS market and what to expect from ABS East.

Affirm has tapped the public/144A ABS market three times so far in 2023 — its latest deal in September raising $750m, marking the firm's largest ABS deal ever. The deal offered a double B tranche for the first time in more than a year, signalling the return of risk appetite in the ABS market.

***GlobalCapital* (GC): How has 2023 been for Affirm and the consumer loan ABS sector so far? Do you feel that demand has been supportive of your issuance?**

Brooke Major-Reid (BMR): Most market participants are still dealing with some level of uncertainty around the Fed — as well as the macroeconomic and geopolitical environments. The consumer has been holding up. But, there is a view that the consumer could feel the pain more severely down the road.

In terms of how it has been for Affirm, we take an engineering-driven approach to managing our business by maintaining excess capacity and always keeping a very close eye on credit. Our underwriting posture is unique, given we are evaluating every individual application before making a credit decision.

It has been rewarding to see us recognised for the credit outcomes we have achieved. This has led to a really constructive tone with our capital partners and pricing.

We have been thoughtful about managing issuance. The tone has been very positive, but we understand that we are not out of the woods, so we are not taking anything for granted.

GC: As a consumer lender, how is your ability to weather the increase in funding costs and what strategies are you using to do this? And what would you highlight when it comes to investors differentiating you from other consumer and other buy now pay later lenders?

BMR: We are managing this in the way we have always managed it. Let's call a spade a spade: we would not feel good about another 500bp increase over 18 months (the fastest pace of increase in benchmark interest rates in four decades). However, we have the ability to manage our funding across channels so that there is not a linear flow through.

We manage our funding structure across warehouses, forward flow and ABS. Because we have demonstrated credit outcomes that are positive and beneficial to investors, we are able to renegotiate some renewals for forward agreements at more favourable spreads.

The revolving deals have a coupon. Every time we do a deal, those get fixed. The flow through has been managed by virtue of the mix of fixed and floating. We reprice as we issue deals when we take market risk at a particular time. So, that's one lever with respect to just how the funding model works — some are floating and some are technically fixed.

Having said that, we also have other business levers, such as renegotiating merchant discount rates (the fees merchants pay Affirm). With the economics of the units, we have been able to maintain merchant discount rates. There have also been pricing initiatives on the consumer side that ensure we are able to continue to offer that flexibility to consumers to pay over time when a product like ours is more valuable.

Fixed income investors are really focused on our ability to manage risk and underwrite, so that they know they are protected. The fact that we underwrite every transaction, the fact that our duration is fairly short and the fact that we have a diversity of product offerings that can sustain the level of growth that we saw last fiscal year really speaks to how we can tier risk and price risk well in this environment.

The major selling point of our space with fixed income investors is: are we managing the quality of the portfolio and are we managing the risk in our book? Our results the past few months have really demonstrated our underwriting and risk management advantages.

GC: The importance of diverse funding channels has been gaining prominence recently, alongside the idea of replacing ABS issuance with different private solutions like we saw in the fourth quarter of 2022. Are you utilising public ABS more or less? Has ABS become more expensive compared with other sources of your funding?

BMR: No one can deny the depth of the ABS market — it's phenomenal. But let me first say that I couldn't be more grateful for Affirm's foundational approach to our funding model. We are not reliant on any one channel. When things got a little dislocated, and the volatility was at all-time highs throughout the past 18 months, we remained committed to being a programmatic issuer. We weren't ever in a position of saying we wouldn't attempt to issue if the market is open. We accessed the market in very challenging times. But we were committed to trying to access the ABS market even when it wasn't as favourable, relative to our options. We were able to say 'okay, we make the decision around using our warehouse lines a little bit more'.

That flexibility is what helps us to navigate and manage the severity of the pricing dislocation. We are under no illusions. Rates have been rising and it will be something we deal with. That's why we are always trying to optimise and make sure that the deals are well structured and well managed during the revolving period. We want to make sure the quality of the collateral is good. We have to prioritise pledging to those trusts and we have the benefit of some of the longer revolving periods in previous deals that were fixed, so we prioritise those.

We tried our best to thoughtfully access the ABS market, as signalled by our last deal, AFFRM 2023-B, which was our largest to date, because we also had other alternatives that were as cost-effective at that time.

GC: On the subject of this year's ABS deals, how satisfied have you been with demand? Which part of the capital stack has been easier or harder to sell?

BMR: We feel really good about the execution. If you look at the tranches we issued, you will notice that AFFRM 2023-B (priced on September 12) was the first time in a year that we issued below investment grade.

Over the last 18 months, it has been incredibly challenging to get momentum around subordinated notes. Investment grade subordinated notes — so, double-A, single-A and triple-B rated notes — were also more challenging to price, relative to the top of the capital stack.

Previously, we just didn't feel that it was suitable in that market to really issue sub-investment grade notes. But given the momentum this time around, with so much more demand down the stack, we were able to tighten the double-B tranche materially. The advance rates went up and the team did a great job. People were feeling good about the structure and the protection.

Before we upsized, the overall deal was over four times oversubscribed. It was tempting to overshoot beyond $750m — but, again, we don't want to necessarily sacrifice availability and what we have committed to in other channels just because we feel like there is a lot of momentum. I felt like the $750m marker was healthy enough to satisfy investor demand, and really set our ability to say okay, we can continue to issue, reopen and expand. As we continue on our journey to being programmatic, you will likely see us doing more deals, so that folks can get liquidity, participate in benchmark issuances, and see enough demand to support secondary activity in a robust manner.

GC: What are you hoping to get out of ABS East? And how do you feel about the fourth quarter, considering all the obstacles faced this year?

BMR: The main objective is to continue building relationships and engaging investors around our programme. We are always looking to optimise to meet their needs and get feedback on structuring, risk appetite, and how they are thinking about the fourth quarter, which is also peak season for us given the retail connection.

Equally important is to ensure that investors continue to understand our model. Investors cover a broad range of issuers, and have lots of different alternatives. The primary objective at this or any conference is to spend time with investors and ensure that they understand our business, how we manage risk, and how we are thinking about growth.

We also want to continue to ensure that we have momentum with respect to receptivity. We want to continue to give investors insight into our approach to risk management and how we manage our book.

The fluidity of the market is something that is super important to us. We hope to contribute to that in a meaningful constructive way. As I sit here today, there's more I need to see before I am fully convinced that we are truly in a fluid, consistent market just yet.

GC: Does this mean you are cautious going into 2024?

BMR: As someone in the business of managing risk, you always have to be disciplined and I would always rather be described as cautious over careless. I am optimistic about the growth of our business. But there are so many exogenous factors on the macro side: student loan debt repayment, the consumer, geopolitical risk, and the Fed. We are optimistic about the prospects of our business, but cautious about the potential headwinds given that we are still working our way through the volatility of the last 18 months.

GC: Do you have a favourite ABS East party that our readers should not miss, or a spot to relax in Miami after a hard day of meetings?

BMR: I think most ABS East parties are actually pretty good! But I tend to do more work than party. It's such a unique time to get to all the investors and talk to really smart people about what's going on.

I tend to use the evenings to meet as many folks as I can. Our partners usually throw parties as well, so I won't choose one, but I will say it is a lot of fun when our partners put on something special for their clients and you get a chance to meet other issuers as well.

This interview was conducted in the last week of September. GC